STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	**1/30/01**	Bill No:	**SB 145**
Tax:	**Sales and Use**	Author:	**Perata**
Board Position:		Related Bills:	

BILL SUMMARY

This bill would delete the January 1, 2003 sunset date for the exemption for fuel sold to water common carriers, thereby extending this exemption indefinitely.

ANALYSIS

Current Law

Among other things, Section 6385 of the Sales and Use Tax Law, as amended by Section 1.5 of Chapter 905 of the Statutes of 1992, exempts from the sales and use tax the gross receipts from the sale of fuel and petroleum products to a water common carrier for immediate shipment outside this state for consumption in conduct of its business as a common carrier after the first out-of-state destination. This exemption requires a water common carrier to only pay tax on the fuel needed to get from California to its first out-of-state destination. This section contains a January 1, 2003 sunset date and will be replaced by a new Section 6385 which does not contain the sales tax on fuel exemption for water common carriers.

Proposed Law

This bill would amend Section 6385 of the Sales and Use Tax Law to delete the January 1, 2003 sunset date on the exemption for fuel and petroleum products sold to water common carriers. This bill would also repeal Section 6385, as added by Section 1.6 of Chapter 905 of the Statutes of 1992, which does not contain that sales tax exemption and was scheduled to become operative on January 1, 2003.

Background

Until July 15, 1991, sales of fuel and petroleum products to water, air, and rail common carriers were exempt from tax when used in the conduct of the carrier's common carrier activities after the first out-of-state destination. The exemption for bunker fuel purchased by qualified waterborne vessels was dependent upon the amount of bunker fuel on board the vessel prior to refueling. If the quantity of bunker fuel on board the vessel on arrival at the California port was sufficient to enable the vessel to reach its first out-of-state destination, then the bunker fuel loaded at the California port would have been entirely exempt from tax. However, if the quantity of bunker fuel needed on the voyage from the California port to the first out-of-state destination and the amount used while in port exceeded the quantity of fuel on board the vessel on arrival at the

California port, the amount of that excess was subject to tax. The exemption was repealed in 1991 by AB 2181 (Ch. 85, 1991) and SB 179 (Ch. 88, 1991).

As a result of the loss of the exemption, the Pacific Merchant Shipping Association sponsored AB 2396 (Ch. 905, 1992) to combat what they claimed was a disastrous tax law change. They argued that the repeal of the exemption for water common carriers resulted in a decline in the number of ships which bunker in California ports. The re-establishment of the exemption was designed to increase bunker activity in California.

Beginning January 1, 1993, as amended by Section 1.5 of Chapter 905 of 1992, Section 6385 once again granted an exemption for bunker fuel for certain uses. That measure, however, contained a sunset provision which would have repealed the exemption on January 1, 1998. Assembly Bill 366 (Ch. 615, 1997) extended the sunset provision until January 1, 2003, and also required the Legislative Analyst's Office (LAO) to study the effects of the bunker fuel exemption and prepare a report of their findings.

COMMENTS

1. **Sponsor and Purpose.** According to the author's office, this bill is sponsored by the Pacific Merchant Shipping Association. The purpose of this bill is to extend indefinitely the bunker fuel exemption that is scheduled to be repealed as of January 1, 2003.
2. **LAO recommends removing the sunset date.** Assembly Bill 366 (Ch. 615, 1997) required the LAO to study the effects of the bunker fuel exemption and prepare a report of their findings. The LAO recently issued their report on the effect of the bunker fuel exemption, and concluded "On this tax policy basis, we recommend that the Legislature remove the existing sunset for the current partial (sales and use tax) exemption for bunker fuel sales, and make the exemption permanent. This would result in the (sales and use tax) being levied in the future only on the portion of the fuel purchased in California which is consumed between California and the first out-of-state destination. This action would result in treating bunker fuel sales similarly to other export sales and place California ports on par with other U.S. out-of-state ports."
3. **Sales tax law for air and rail common carriers.** Section 6357.5 of the Sales and Use Tax Law contains an exemption for fuel sold to an air common carrier for immediate consumption or shipment in the conduct of its business on an international flight. Fuel purchased for domestic flights is not included in the exemption.

   Fuel sold to rail common carriers remains subject to the sales tax.
4. **The Board does not foresee any administrative problems with this measure.** The continuation of the current exemption as proposed by this measure could be easily administered by the Board.

COST ESTIMATE

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

Some costs would be incurred in revising publications and notifying the public and Board staff. These costs would be absorbable.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

The United States Energy Information Administration reports that sales of bunker fuel in California during 1999 amounted to 1,232,773,000 gallons. Since there are 42 gallons to a barrel of bunker fuel, sales of bunker fuel in barrels amounted to 29.4 million barrels. The California Energy Commission reports that the average price per barrel for bunker fuel sold in California was $20.80 during the month of January 2001. Total annual sales of bunker fuel are estimated to be $611.5 million. (29.4 million barrels x $20.80 per barrel = $611.5 million.)

A portion of these sales is currently taxable as it is used prior to the first out-of-state destination. In a study done by Price Waterhouse for the Pacific Merchant Shipping Association (PMSA), it was estimated that 12% of bunker fuel is used prior to the first out-of-state destination. If we apply this percentage to the $611.5 million in sales, $73.3 million in sales of bunker fuel is currently subject to the sales and use tax. The remaining $538.1 million in sales is currently exempt from the sales and use.

During the recession of the early 1990s, the exemption for bunker fuel used after the first out-of-state destination was repealed. The exemption was reinstated on January 1, 1993 with a sunset date of January 1, 1998. This sunset date was extended to January 1, 2003 in legislation that passed in 1997. Bunker fuel sales declined dramatically in the early 1990s, due primarily to the worldwide effects of the recession. Sales of bunker fuel in the Los Angeles customs area dropped by over 50% in 1992. The 1997 legislation that extended the exemption required that the Legislative Analyst's Office (LAO) prepare a report regarding the taxation of bunker fuel. That report was issued on January 25, 2001. The LAO found that the decline in bunker fuel sales in the early 1990s had little to do with the imposition of sales tax. The report further concludes that the reinstatement of the exemption did not result in an increase of bunker fuel sales. However, the report points out that the cost of bunker fuel is a major component of the operating costs for shipping. Shippers also have a great deal of flexibility with regard to when and where they purchase bunker fuel. For those reasons, the LAO believes that under current conditions, the reimposition of the sales tax on bunker fuel would generate a decline in the sales of bunker fuel.

Determining the amount of this decline in sales is difficult, as there are a number of variables involved in the decision as to where to obtain bunker fuel. Price is only one of those variables, albeit an important one. For example, ships at times need to purchase bunker fuel to use as ballast to stabilize the ship for safety reasons. Based on discussions with the LAO and PMSA, it is estimated that sales will decline from between 20% and 50%. Therefore, the sales of bunker fuel that would be subject to the sales and use tax, if the exemption is allowed to sunset, are estimated to be between $269.1 million and $430.5 million annually. ($538.1 million x 50% = $269.1 million; $538.1 million x 80% = $430.5 million.)

Revenue Summary

The revenue impact from deleting the sunset date on the sales and use tax exemption for fuel and petroleum products sold to a water common carrier, for immediate shipment outside this state for consumption in the conduct of its business as a common carrier after the first out of state destination would be as follows:

		Continued Revenue Reduction		
Fuel & Petroleum Sales	between	$ 269.1 million	and	$ 430.5 million
State loss (5%)*	between	$ 13.5 million	and	$ 21.5 million
Local loss (2.25%)	between	6.1 million	and	9.7 million
Transit loss (1%)**	between	2.7 million	and	4.3 million
Total	between	$ 22.3 million	and	$ 35.5 million

* While the state tax rate is 4.75 percent for calendar year 2001, it is assumed the tax rate will return to 5.0 percent in 2002.

* Nearly all of the bunker fuel is sold in jurisdictions with a tax rate of 8.25%.

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